MEMO

To: MA RGGI Auction Advisory Committee
From: Rachel Evans, MA DOER
William Lamkin, MA DEP
Date: January 8, 2013

Re: Unsold Massachusetts RGGI Allowances from 2012

Consistent with its recommendation for the First Compliance Period[1], staff recommends that DOER retire the 10,304,989 unsold Massachusetts RGGI allowances from 2012, contingent upon agreement from the other participating states to act in a similar manner. This will allow a clean slate for the participating states to undertake a redesign of the RGGI program, to better achieve the long-term goals set forth in the RGGI MOU. For Massachusetts, this action would also be consistent with the goals and mandates of the Green Communities Act and the Massachusetts Global Warming Solutions Act.

I. The Regional Greenhouse Gas Initiative

In 2003 the states of Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont began discussions to develop a regional cap-and-trade program addressing carbon dioxide emissions from power plants. This effort became the Regional Greenhouse Gas Initiative (RGGI). The intent and purpose of the RGGI program is to:

- create and implement an emission budget and allowance[2] trading system to stabilize and then modestly reduce carbon dioxide emissions emitted from fossil fuel fired electric generating facilities,
- be consistent with continued economic growth, and
- maintain a safe, reliable electric system.

Each of the states committed staff from their respective environmental and energy agencies to develop and outline the components of a regional cap and trade program. Under the direction of their respective state agencies, staff gathered emissions data and input from experts and stakeholders. The states retained electric system and economic modeling consultants to lay the groundwork for the design of the program.

In December of 2005, the director of each state energy and environmental agency ("Agency Heads") gathered to discuss program elements and make key policy decisions, including the overall cap level and state by state allocations. These decisions were memorialized in a Memorandum of Understanding[3] (MOU) signed by seven of the states in December of 2005. Through the MOU, each state committed to propose, for legislative or regulatory approval, the RGGI program as substantially reflected in a Model Rule[4]. Massachusetts signed the MOU in January 2007 when Governor Patrick took office, followed closely thereafter by Rhode Island. Maryland signed the MOU later in 2007, making it the tenth

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[1] See previous recommendation, dated December 22, 2011 at http://www.mass.gov/eea/docs/doer/rggi/unsold-allowances-memo-.pdf (last visited 1/3/13).
[2] An allowance is a limited authorization to emit one ton of carbon dioxide.
[3] http://www.rggi.org/design/history/mou
[4] http://www.rggi.org/design/history/model_rule

participating state. The first RGGI auction was conducted in September 2008 and the first three-year Control Period began on January 1, 2009.

The actions of the Massachusetts Department of Environmental Protection ("DEP") and the Department of Energy Resources ("DOER") in designing and implementing the RGGI program have been affirmed and strengthened by the Massachusetts legislature. The Green Communities Act [5] directed the Executive Office of Energy and Environmental Affairs, through DOER, to dedicate 80% of the auction proceeds to energy efficiency programs. Shortly thereafter, pursuant to The Global Warming Solutions Act[6], Massachusetts developed a climate plan to reduce statewide carbon dioxide equivalent emissions by 25% by the year 2020.

II. Program Review

Pursuant to Section 6(D) of the RGGI MOU, Massachusetts and the other RGGI states undertook a comprehensive program review in 2012, including:

- Gathered analytic material on topics such as the CO_2 allowance budget, disposition of unsold allowances, allowance reserve flexibility mechanisms, electricity imports and offsets.
- Conducted learning sessions with experts and stakeholders for additional topics to address, such as CO_2 allowance budget, disposition of unsold allowances, allowance reserve flexibility mechanisms, and electricity imports.
- Conducted macro-economic modeling of selected policy cases.
- Held multiple stakeholder meetings to solicit comments on the IPM Model Reference Case, Sensitivity Analyses, policy scenarios, macro-economic modeling, and electric-bill-impact analysis.
- Considered the analyses and stakeholder comments on program success, program operations, additional reductions, imports and emissions leakage, offsets, and economic impacts.
- Assembled a comprehensive set of recommendations for each state to consider.

As this comprehensive program review concludes in January 2013, the states will each make a determination regarding the recommendations for comprehensive program changes and initiate any state specific rule-making processes to be effective during the second control period (2012-2014).

III. MA Auction Advisory Committee

The Massachusetts DOER (formerly known as the Division of Energy Resources) provides for Program Review in its CO_2 Budget Trading Program Auction Regulation at 225 CMR 13.06(9):

> In 2012, the Division may evaluate the auction program performance and may retire any previous allocation year allowances that were offered for sale by auction but were not sold and still remain in the Massachusetts Auction Account. The Division will consult with the Auction Advisory Committee and will solicit public

[5] http://www.malegislature.gov/Laws/SessionLaws/Acts/2008/Chapter169
[6] http://www.malegislature.gov/Laws/SessionLaws/Acts/2008/Chapter298

comment prior to retiring any such allowances.

The DOER regulation also provide for the formation of the Auction Advisory Committee ("AAC"):

> Auction Advisory Committee: A committee chaired by the Commissioner of the Division of Energy Resources and comprised of the Secretary of the Executive Office of Energy and Environmental Affairs, the Secretary of the Executive Office of Administration and Finance, and the Commissioner of the Department of Environmental Protection, or their respective designees, established to advise the Division on procedures relevant to conducting the auctions prescribed in this regulation.

Commissioner Mark Sylvia of DOER, as chairman, has convened the AAC in 2012 to advise him on implementing a review of the Massachusetts RGGI program. The members of the AAC are Barbara Kates-Garnick, Undersecretary for Energy, as designated by Secretary Sullivan on behalf of the Executive Office of Energy and the Environment; Commissioner Kenneth Kimmell of the DEP; and Matthew Cole, Fiscal Policy Analyst, as designated by Secretary Gonzales on behalf of the Executive Office for Administration and Finance.

IV. Over-Supply and Unsold RGGI Allowances

Each state's emissions budget ("state caps") contained in the MOU was based largely upon its historic emissions levels and future emission projections. Collectively the total of the state caps equals the regional cap. However, between 2005, when the state caps were established, and 2009, when the program launched, annual emissions for the region dropped significantly. Those emission reductions were due to a number of factors identified in a study[7] conducted for RGGI by the New York State Energy Research Authority, which found that:

- Approximately 48% of the reduced emissions 2009 vs. 2005 were due to factors that affect load:
  - Weather 24%
  - Energy Efficiency investment 12%
  - The economy 4.4%
  - Other load impact factors 7.6%
- Approximately 31% of the reduced emissions 2009 vs. 2005 were due to changes in relative fuel prices:
  - Shale gas is the significant driver here, making gas cheaper compared to coal and oil.
- Approximately 21% of the reduced emissions 2009 vs. 2005 were due to changes in available capacity mix:
  - Less Coal, more renewable (wind, solar, etc.).

These factors have resulted in total annual emissions in the region being significantly less the 188 million ton regional emissions cap that was established in 2005. Since New Jersey left RGGI at the end of 2011, the nine-state regional cap is 165 million tons per year. This has resulted in a significant over-allocation of allowances in the RGGI cap and trade system that has resulted in very low prices and low demand at auction.

[7] http://rggi.org/docs/Retrospective_Analysis_Draft_White_Paper.pdf

The RGGI program was designed for allowance prices to achieve the program goal of carbon dioxide in two distinct ways. First, the price on carbon emissions is meant to create an economic incentive for regulated facilities to change their collective behaviors in a way that will reduce emissions. Second, the states have committed to invest a large portion of proceeds to investment in energy efficiency. These energy efficiency investments have and will continue to yield carbon dioxide emission reductions while at the same time providing economic benefits and jobs to the region. The Analysis Group, an economic consulting firm, very recently released an independent report on the economic impacts of RGGI. The Analysis Group Report[8] concludes that the ten states auctioned $912 million worth of allowances in the first 13 auctions. The states have reinvested the large majority of those auction proceeds within the region. Those investments by the states have generated $1.6 billion in economic value to the region and have resulted in 16,000 jobs.

The oversupply of carbon allowances has the potential to impact the long term environmental integrity of the RGGI program. With the oversupply of allowances, the cap becomes non binding (i.e. the cap will not limit emissions of carbon dioxide to achieve the original program intent to stabilize and then reduce emissions). It is critical to address the oversupply of allowances if the states are to achieve the program goals moving forward. The reserve price at which allowances are currently trading may not be sending an adequate price signal to the market to influence behavior.

Based on the total emissions for the first Compliance Period, there were approximately 47 million more allowances in circulation (sold at auction or otherwise distributed by the states) than needed for compliance in the first Compliance Period. These allowances in circulation are not under the control of the states; they are held primarily by compliance entities. The Market Monitor's Report[9] from Auction 18 stated: "Compliance entities and their affiliates will hold 94 percent of the allowances in circulation following the settlement of allowances sold in Auction 18."

In accordance with its regulations and based on the Auction Advisory Committee's recommendation on December 22, 2011, Massachusetts retired the 16,831,266 unsold RGGI allowances that it held from the First Compliance Period, contingent upon agreement from the other participating states committing to similarly retire or hold unsold First Compliance Period allowances held by their respective states. However, this oversupply of allowances has continued during 2012, and Massachusetts now has accumulated an additional surplus of 10,304,989 allowances for vintage year for 2012, that were offered for sale but not purchased.

V. Staff Recommendation

Based on the foregoing determination that there is a continuing, significant oversupply of carbon dioxide allowances, DEP and DOER staff recommends that DOER retire the 10,304,989 unsold Massachusetts RGGI allowances from 2012, contingent upon agreement from the other participating states to act in a similar manner. This will allow a clean slate for the participating states to undertake a redesign of the RGGI program, to better achieve the long-term goals set forth in the RGGI MOU. For Massachusetts, this action would also be consistent with the goals and mandates of the Green Communities Act and the Massachusetts Global Warming Solutions Act.

[8] http://www.analysisgroup.com/uploadedFiles/Publishing/Articles/Economic_Impact_RGGI_Report.pdf

[9] http://www.rggi.org/docs/Auctions/18/Auction_18_Market_Monitor_Report.pdf

VI. Request for Comment

The public is invited to submit written comments, regarding the retirement of unsold allowances, to the Auction Advisory Committee by 5 pm, on Friday, **January 18, 2013**, at the following address:

Auction Advisory Committee
Department of Energy Resources
100 Cambridge Street, Suite 1020
Boston, MA 02114

Or by email to: RGGI.AAC@state.ma.us